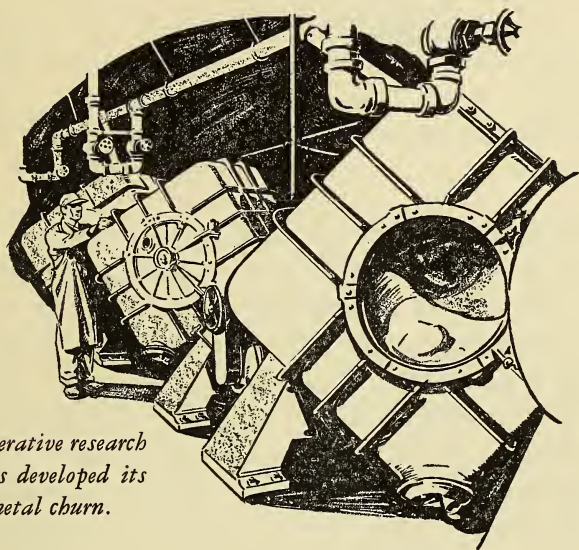
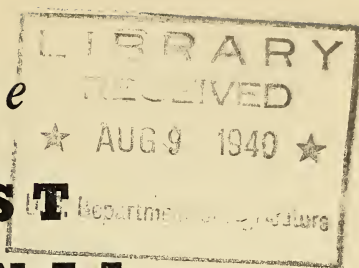


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5223-28
Cooperative technique

in a **WEST COAST**
DAIRY REGIONAL

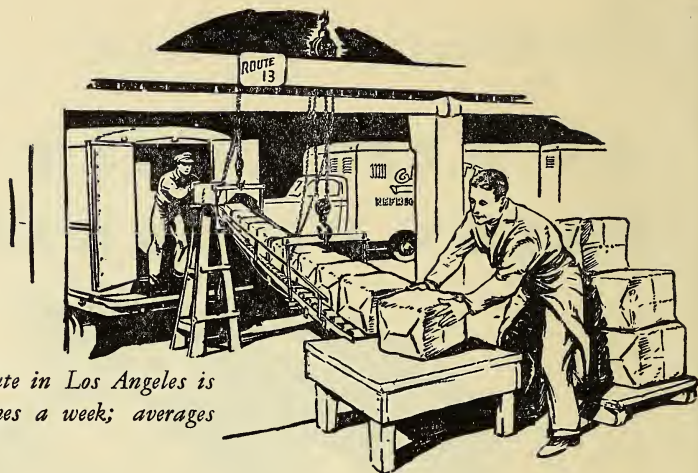


*Through cooperative research
Challenge has developed its
own type of metal churn.*

LIKE each of the eight regional cooperatives in the United States engaged in handling dairy products, the Challenge Cream & Butter Association of Los Angeles has developed a number of distinct features of its own. Some of these have to do with its marketing program; others with its cooperative procedure. Many of them are influenced to some extent by its geographic location.

Although its marketing program may not be adaptable in all its details for use in other parts of the country, much of its cooperative procedure is distinctly so. Challenge has raised many cooperative practices almost to the nth power. The extent to which it applies fundamental principles is in many instances exemplary.

In its marketing program, Challenge is distinguished by the fact that it is the only one of the regionals carrying a complete



A typical butter route in Los Angeles is serviced 2 or 3 times a week; averages about 70 stops.

line of dairy products as far toward the consumer as the retail store. This does not suggest that a similar plan of distribution is in order for all other dairy co-ops—but rather that the particular marketing needs of the farmers in the Challenge territory call for this type of operation.

California is a deficit State for manufactured dairy products, especially butter. For this reason supplies from the Mountain and Pacific Slope States naturally find their way to its markets. Before cooperative organization, however, dairymen found themselves competing with each other and taking a loss in net returns through wasteful marketing methods.

The organization and growth of Challenge has been the result of deliberate cooperative action to overcome this handicap. The small local group in Tulare County from which it grew temporarily solved the problem 30 years ago when it developed an outlet which netted fully 5 cents more per pound of butter than had previously been received in relation to the Los Angeles market.

The solution was short-lived. Within 6 months its outlet was shut off.

No new satisfactory outlets could be found. The one road remaining open was to market the butter directly to retail stores. A 1-horse delivery wagon and 4 employees was the Challenge of its day—the forerunner of the present fleet of

more than 200 streamlined trucks and a dozen modern warehouses that supply nearly 20 million dollars' worth of dairy products annually, direct to the retail trade.

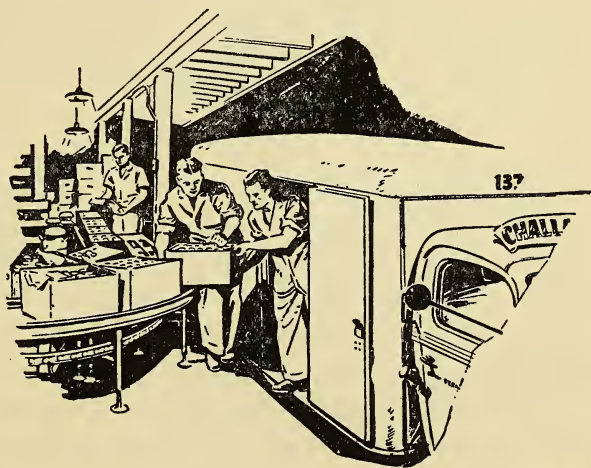
Thus it is that direct distribution is a feature of Challenge's marketing program. Tied in with this is its policy of handling all types of dairy products. This is considered desirable in order to furnish market outlets for all of the products its members have to sell; to make the most efficient use of its facilities and personnel; and to encourage the sale of butter by being able to furnish customers with all of their other dairy products as well.

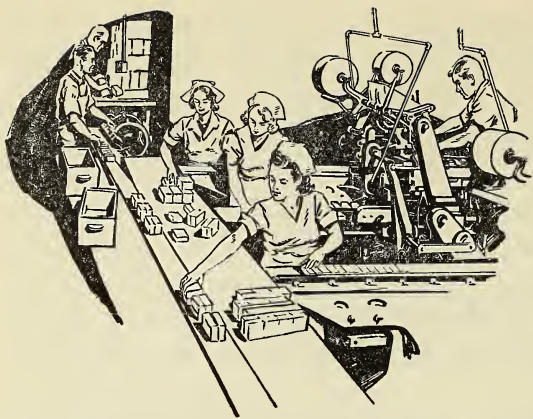
Underlying these policies, and the basic rule of all its operation, is the policy of quality. Quality butter was its entering wedge in first finding a market, and quality still is considered its chief asset in acquiring and maintaining outlets.

Cooperative Procedure Laid on Sound Lines

In its general set-up, Challenge can perhaps be described as a Simon-pure cooperative. It adheres to the principle of democratic control; it limits the interest paid on invested capital; it confines operations almost exclusively to member volume. The cooperative rule that members should furnish capital in direct proportion to the extent they use the association, and that savings be distributed on the basis of patronage, is followed almost to the last decimal point.

No milk is sold retail to homes; in 1939, 48 milk trucks served some 1,900 Los Angeles wholesale customers.





Nearly all member creameries ship their butter in bulk to the Challenge plants, where large-scale operations permit economies in printing and wrapping

At the same time it is notable that the cooperative pattern of Challenge itself is not always so closely followed by its member associations. Furthermore, many of the 33,000 dairymen who use Challenge do not fully understand it. They are relatively unfamiliar with their responsibilities to and their benefits through their cooperative enterprise.

This is explained to some extent by the inherent difficulties in maintaining a close-knit organization over far-flung territory. It is explained further by the fact that in hewing so closely to the cooperative line of procedure, Challenge has developed accounting details and terminology that are not always easily understood.

Challenge is controlled by its 37 member associations in California, Idaho, Oregon, Colorado, Wyoming, Utah, Washington, and Nevada. Each of them is a self-governing local cooperative. Each of them has equal representation on the board of directors of the federation. The members and the patrons are identical. Thus those who control the operating policies are those whom the association is intended to benefit and no others.

Those who control the association, moreover, do not control because they have contributed capital, but because they are its patrons—another important cooperative principle. The membership fee in this nonstock set-up is \$1,000, a mere “drop in the bucket” in the financing of a 3-million-dollar organization.

In its financing, Challenge very carefully follows a universally accepted fundamental of sound cooperative business. This

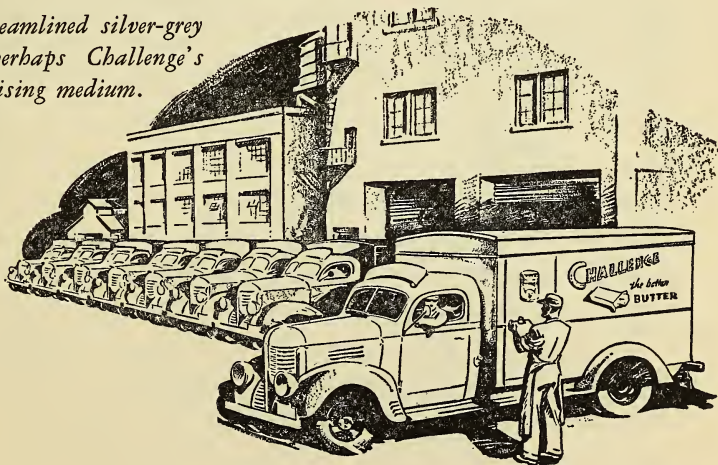
principle, already referred to, demands that members assume a financial responsibility for their organization in direct proportion to their use and benefits of the services. This applies both to the capital required to finance its facilities and to the funds needed for day-to-day operations.

In the case of the capital structure, the financing is through retains made on each unit of product handled, plus undistributed balances accumulated through the year. The members, or local associations, are credited with the amounts retained and are issued a certificate of interest each year representing their respective contributions to the total capital. Every dollar of Challenge's net worth is allocated to members on a patronage basis.

The capital fund represented by the certificates is subject to distribution at the discretion of the board of directors. The directors may, but are not obligated to, authorize the payment of interest at a rate not to exceed 8 percent. The policy has been to pay one-half percent a month.

Since 1923 the total additions to capital have aggregated \$2,508,008. The capital account began to revolve in 1927 when the oldest certificates were retired, and by the end of 1939, \$1,188,008 had been refunded to the locals, leaving \$1,319,999 outstanding. This revolving capital system, based on a combination of per-unit deductions and retained patronage dividends, not only provides adequate capital but assures that

A fleet of 225 streamlined silver-grey motortrucks is perhaps Challenge's best single advertising medium.



the financial support of Challenge falls squarely on the shoulders of those who actually use its facilities.

Every patron of Challenge also provides operating capital and assumes the risks of the business in direct proportion to patronage. This is logical inasmuch as those who supply patronage receive the benefits from the operation. The procedure is simple to state, but rather complicated in its detail.

Every Product Pays Its Way

It is accomplished by letting each product pay its own way. It pays its own way literally; not figuratively. Each pound of butter and every unit of the 17 other dairy products goes into a monthly pool of its own. Each pound of butter and every other unit bears all of its handling costs and an exact proportion of each item that makes up overhead expense. The pools are clear cut and stand on their own. No product subsidizes or is subsidized by another product.

When the books of a pool are closed, it is to find out what the members have due them, not to find out what the business gained or lost. There is no question of under- or over-payment; no board meeting to consider pay-out prices, and no setting of prices to meet competition. The pool prices are purely the results obtained by adequate accounting for the proceeds from sale.

The method by which Challenge members provide it with operating capital is through delayed settlements on the pools. This is a customary procedure in dairy cooperatives, most of which settle for all of the butterfat delivered during a calendar period on a certain set date after the close of the period. This means that deliveries made during the early days of a pool period wait longer for settlement advances than those delivered toward the end of the period. Challenge, however, has adopted a uniformly delayed settlement plan under which its trade acceptances are payable 18 days after delivery.

As far as Challenge is concerned, this procedure leaves in its hands the members' products or the returns therefrom for 18 days after delivery, and thus furnishes operating capital. As far as the member units are concerned, they hold acceptances in

direct proportion to the value of the products marketed, and the responsibility of furnishing the operating capital is therefore distributed equitably.

Accurate Accounting Assures Equitable Returns

Settlements on each pool are made in two parts. The first part is the advance, made with the trade acceptances which are payable in 18 days. The advances are set according to a specific schedule which is based on market prices and quality.

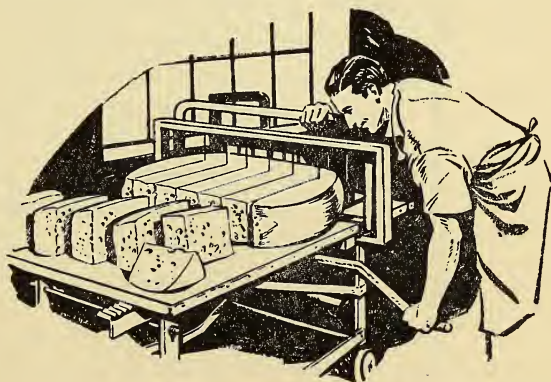
The second part of the settlement, which is called the "additional," is the difference between the first amount advanced and the gross sales value. The two items together represent the total sales value of a product, say butter. From the total sales value, credited to the member, there must be deducted the total expenses of operation before the net pool returns are arrived at.

To take butter as an illustration, two expense items are charged against each local's account—budget and advertising.

The budget is used in lieu of actual expenses to permit closing the books for each pool earlier than the exact expenses can be known. Differences between actual and estimated expenses are adjusted monthly, and on December 31 any net under or over charge in the budget is adjusted into the locals' accounts. The advertising fund is based on specific per unit deductions in the same manner as revolving capital and is handled in a separate and distinct account.

In order to maintain equity among the affiliated locals and among the products handled, all expenses are allocated pre-

Since 1934 cheese volume has averaged around 4 million pounds annually; 5- and 2-pound loaves in special wrappers are big selling items.



cisely. To begin with, all the direct expenses are charged to the products or pools directly affected. The real problem is in allocating in an equitable manner the many items which make up overhead expenses. For this purpose, Challenge has adopted a "unit" system of expense allocation.

The number of units of each product sold during the month are converted to standard or accounting units by a schedule of ratios. For example, 1 pound of butter is 1 unit, 5 pounds of cheese is 3 units, and so on. The standard units of each product are then expressed as a percentage of the total standard units. This percentage thus becomes that product's share in the overhead. For example, butter may bear 75 percent, whey powder less than 1 percent.

In this as in other details, Challenge follows not only the letter but the spirit of cooperative dealing. It shares equitably between its members the economies of large-scale operations and the advantages of concentrated volume.

The member associations of Challenge recognize their responsibility in controlling, financing, and providing volume for their business enterprise. The farmers who make up these local units have a similar responsibility to their locals. The extent to which these responsibilities are recognized is a measure of the cooperative strength of the entire organization "from the grass roots up."

This leaflet is condensed from Circular C-119, "Operating Methods of Challenge Cream & Butter Association," by Paul E. Quintus, agricultural economist. Copies of this larger publication with more detailed information may be obtained, while available, from—

Information and Extension Division
Farm Credit Administration
United States Department of Agriculture
Washington, D. C.